László Domokos

Lack of transparency hindering foresight in the planning and execution of the budget[1]

The global financial crisis hit the real economy and hence, public finances of most countries in the world so hard that even national audit offices, which are responsible for the regular and effective spending of public funds, had to ask themselves how they could assist in preventing the outbreak or at least the deepening of economic crises and in mitigating their the negative effects. The quick response of the International Organization of Supreme Audit Institutions (INTOSAI) reflects this sense of responsibility: as early as its first meeting in November 2008, the Governing Board set up a working group to examine the challenges posed by the global financial crisis for state audit offices. Of the partial report that has been recently discussed in London, I would like to highlight one thought only: national audit offices are a part of the respective immune systems of individual countries. Accordingly, by being independent and vested with adequate powers, as well as by exercising such powers, the state audit office can contribute significantly to safeguarding the soundness of the economy, financial system and public finances of a country.

In my opinion, a state audit office fulfils its role of being a part of the immune system primarily by drawing attention to disorder and demanding order; in other words, demanding the transparency of public finances and the regular and effective use of public funds. Order, in turn, creates value. Why? Because order improves the chance for clear-sightedness. Clear-sightedness is precisely what would have been needed most in a crisis situation.

THE IMPACT OF THE GLOBAL FINANCIAL CRISIS ON THE HUNGARIAN ECONOMY

Were the global financial crisis and its impact on the Hungarian economy and public finances foreseeable? Its exact magnitude certainly was not. However, by as early as September 2008 it became obvious that the collapse of the US mortgage market would snowball into a global crisis with a devastating effect on the Hungarian economy as well. Nevertheless, even after several amendments, the budget for 2009 was built on unrealistic assumptions, which delayed the flexible adjustment of the Hungarian economy to global economic developments. Foresight was hampered, in part, by a lack of clear-sightedness, namely, a lack of transparency in the general government's reporting system; a situation to which the State Audit Office of Hungary (SAO) had repeatedly objected for years. In the opinion issued by the State Audit Office on the final accounts for 2009 we had to conclude once again that the multi-volume document of the final accounts bill failed to ensure transparency and comparability between years.

In all probability, the former government itself was unable to find its way around the inscrutable system the general government had become. Indeed, the only way it could adjust the figures of the draft budget submitted in the place of the withdrawn bill (that had assumed a three per cent GDP increase) to the macroeconomic projection (that assumed stagnation) was through an MP amendment package. The SAO found severe risks in the draft budget as well, even though it only had a few days to review the documents. I would like to emphasise only two of the risk factors explored. The SAO opinion pointed out that the government's forecast of a 0.6 per cent layoff rate carried a risk, as the financial crisis may affect the real economy more seriously than expected, potentially resulting in a 2.5–3 per cent decline in employment, which may have an impact on both the wage bill and the budget deficit.

"*As regards the developments in wages and household consumption, the fact that the macroeconomic forecast did not adequately take into account the expected loss of that portion of consumption that had been financed by loans in the last two years, implies a risk factor*" – states the opinion issued by SAO. "*A greater fall in employment, shrinking borrowing opportunities and the tightening of lending conditions may lead to a further decline in demand, hence a greater fall in consumption and GDP*".

The alarm bells rung by SAO were justified: the decline in employment and the fall in budget revenues significantly exceeded the government's optimistic forecasts *(see Table 1)*.

By the fourth quarter of 2008 the unemployment rate in Hungary increased to 8 per cent from 7.7 per cent observed in the third quarter of 2008, and it reached 10.5 per cent by the fourth quarter of 2009. In absolute terms, by the end of 2009 the number of the unemployed increased by 115 thousand compared to the third quarter of 2008.[2]

DISORDER AND ITS CONSEQUENCES

However, the disorder started years earlier than 2009. It is worth looking at the economic growth and budget balance data of the five countries that joined the European Union in 2004; Hungary has been the straggler every year since 2005 in both charts *(see Charts 1 and 2)*.

Following their accession to the EU, all of the other countries took compliance with the Maastricht criteria seriously. In this context, the nearly 10 per cent Hungarian budget deficit in 2006 appears strikingly negative (even the second highest deficit is below 4 per cent). The

Table 1

CHANGES IN GDP AND ITS COMPONENTS IN 2009 AS A PERCENTAGE OF THE PREVIOUS YEAR

(government projection for 2009 and the actual figures)

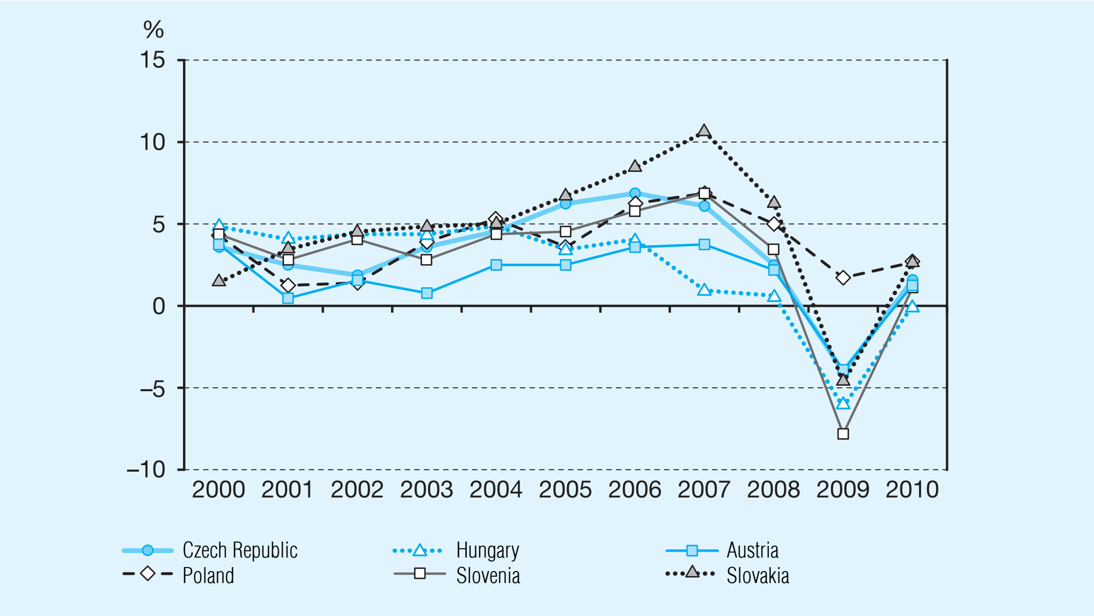
	Government projection for 2009	Actual figures for 2009
GDP (at previous year's prices)	–1.0	–6.3
Household consumption expenditures	–3.8	–7.6
Public consumption	0.2	1.0
Gross fixed capital formation	–0.9	–6.5
Exports of products and services	3.9	–10.1
Imports of products and services	2.4	–16.1

Source: CSO, in relation to the forecast attached to the budget appropriation bill for 2009 and to the actual figures.

Chart 1

GDP GROWTH RATE

(previous year = 100%)



Source: EUROSTAT

Chart 2

BUDGET DEFICIT

(as a percentage of GDP)

Source: EUROSTAT

subsequent, inevitable austerity budget yielded an economic growth that hardly exceeded one per cent. At a time when the other four countries achieved dynamic economic growth, the Hungarian economy stagnated. In its opinion on the budget appropriation bill for 2006 the SAO voiced concerns that revenues in the draft budget were exaggerated, while expenditures were underplanned. However, in the lack of a system of budgetary rules, there was no order to force the government to present fair figures. As a result of this nosedive, Hungary had hit the bottom even before the crisis struck and was dragged down deeper for having accumulated debt instead of reserves in a period of global economic growth. There were no budget resources to mitigate the consequences of the crisis Hungary faced. Moreover, in an attempt to prevent the fiscal position of the country from completely falling apart, the government was forced to cut budgetary expenditures, which deepened the crisis even further. Of these items I would like to highlight the following two.

First, despite the dramatic increase in unemployment there were no additional resources to finance the expansion of programmes promoting employment. Quite the contrary: as the government had underestimated the detrimental developments in unemployment, appropriations for the financing of active employment tools and employment rehabilitation programmes had to be reduced during the year, given that the amount of passive allowances job-seekers are entitled to receive significantly exceeded the underplanned appropriations as a result of high unemployment *(see Table 2)*.[3]

Housing subsidy is another important area where the adoption of fund-reducing measures instead of expedient incentive steps deepened the crisis. The relevant investigation carried out by the SAO in 2008 revealed that home-building between 2005 and 2008 was mostly financed by low-interest Swiss franc denominated loans to households and entrepreneurs *(see Chart 3)*.

As a result of the global financial crisis, this borrowing option contracted to the minimum from the end of 2008. In early 2009, the analysis of the Research Institute of the SAO of the risks posed by the global economic crisis warned that the drying up of the source of loans extended in Swiss francs would send the home construction market tumbling.[4] Despite this obvious interrelationship, for austerity reasons, the Hungarian government decided to cut home-building subsidies drastically. The

Table 2

AMENDED BUDGETARY APPROPRIATIONS AND ACTUAL FIGURES OF SELECTED EXPENDITURES OF THE LABOUR MARKET FUND FOR 2009

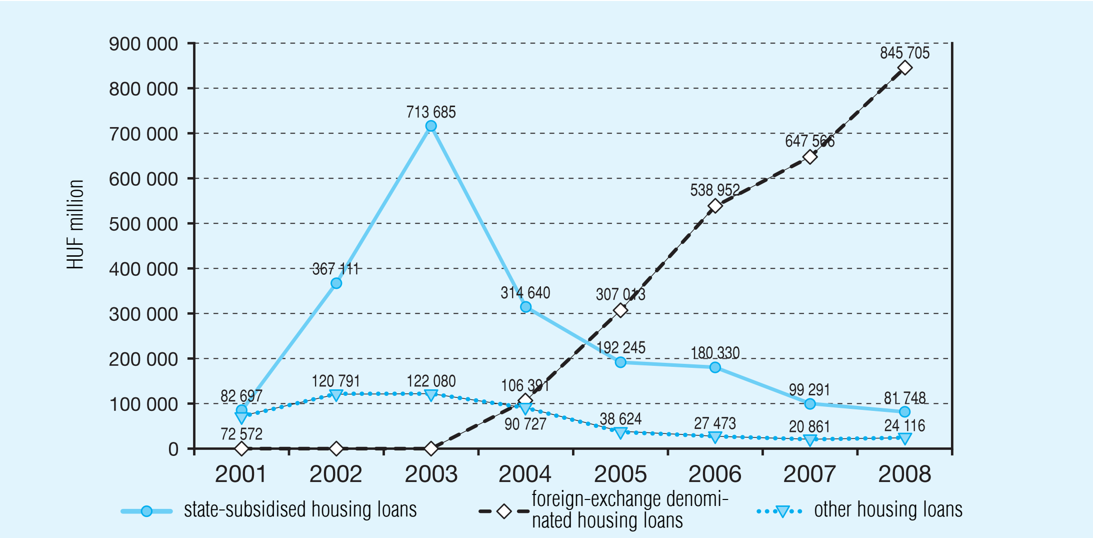
(HUF millions)

Description of the appropriation	Appropriation	Actual figure
Employment and training assistance	46 009.6	39 624.7
TÁMOP (Social Renewal Operational Programme) 1.1 Labour market services and assistance	22 477.0	20 241.6
TÁMOP 1.2 Normative grants to promote employment	9 110.1	4 111.6
Payments for vocational training and adult education	24 533.8	19 535.0
Aid granted for job-creation with a rehabilitation objective	4 000.0	617.1
Job-seeking grants	100 040.0	139 622.1
Entrepreneurs' allowance	1 680.0	2 640.1
Wage guarantee payments	5 250.0	9 179.8

Source: Final accounts bill for 2009

Chart 3

AMOUNT OF HOUSING LOANS APPROVED IN THE PERIOD UNDER REVIEW



Source: SAO report on the audit on the efficiency of the housing subsidy system, Budapest, April 2009, page 20. The source of the data is the CSO.

"result":

- compared to the previous year, in 2009 the number and amount of approved loans fell by 62 per cent and 66 per cent, respectively;
- the number of flats handed over declined by 25 per cent;
- the number of building permits issued for new homes fell by 40 per cent;
- Production declined by 10–25 per cent in the main industries that produce basic materials for and are suppliers of the construction industry.[5]

According to the final accounts bill, the subsidy cut achieved in relation to the housing subsidy appropriation barely exceeded HUF 5 billion,[6] which seems negligible relative to the damage it caused.

We may conclude that order also means discipline. It means the development of, and compliance with, reasonable budget rules. Of course, economists will never agree on what could be considered "reasonable". For example, in calculating the Maastricht criteria, is it reasonable and fair to disregard the fact that the additional budget expenditures resulting from the pension reform are offset by the accumulated savings in the private pension scheme? Had it been fully recognised, in 2009 the GDP-proportionate Hungarian general government deficit and public debt would have been lower by 1.4 percentage points and 9.4 percentage points, respectively *(see Table 3)*.

However, it is undeniable that Hungary should not have accumulated an extremely high budget deficit and increased its indebtedness steadily in a benign global economic environment in the first place, for this is why it was forced to take fiscal austerity measures in the midst of the crisis. Foreign examples show that the number of the unemployed could be lower by hundreds of thousands if, similarly to other countries, Hungary had been able to launch carefully planned programmes to mitigate the negative effects of the crisis.

Another obvious conclusion is that restrictions alone do not generate a sustained equilibrium; without growth it cannot be achieved. However, relieving the economy of

Table 3

BUDGETARY SUBSIDY COMPENSATING FOR THE LOSS OF SOCIAL SECURITY CONTRIBUTIONS RESULTING FROM PRIVATE PENSION FUND JOINERS VERSUS PRIVATE PENSION FUND SAVINGS, AS A PERCENTAGE OF GDP

Year	Private pension fund savings as a percentage of GDP	Budgetary subsidy compensating for the loss of social security contributions resulting from private pension fund joiners as a percentage of GDP
2000	1.29	0.47
2001	1.85	0.53
2002	2.34	0.51
2003	2.99	0.69
2004	3.85	0.81
2005	5.11	0.96
2006	6.29	1.01
2007	8.00	1.17
2008	6.65	1.24
2009	9.40	1.36

Source: own calculation based on data received from the HFSA and the CSO

unnecessary burdens is a prerequisite for growth. This does not necessarily mean further curtailments. Almost all audits conducted by the SAO find a great number of seemingly small holes in the audited area through which every tax forint paid in is money down the drain. Filling these holes and terminating superfluous overlaps, in other words, establishing order, could save billions of forints. The SAO issued recommendations to that effect every year; however, only a few of those have been implemented. I will do my best to change this in the future.

A NEW CONSTITUTION COULD ESTABLISH ORDER IN PUBLIC FINANCES

Developing a new Constitution provides an excellent opportunity to establish the legal background for putting public finances in order. Systemic regulation of public finances is absent from the current Constitution of Hungary. Public finances cover the regulation of public dues, the definition of the subsystems of public finances, the regulation of the sustainability, development, adoption, execution and auditing of the subsystems' budget, the definition of the types of budgetary organisations, the regulation of their establishment, financial management and the auditing of their financial management as well as the regulation of the financial management of state assets and its auditing procedures. The Constitution contains only scattered provisions regarding these issues, usually in the form of summary declarations. It lacks a system of standards ensuring the sustainability of the budget, the definition of the main content components of the budget and the final accounts or a regulation providing for their preparation and adoption.

Citizens are entitled to financial security; consequently, a stable regulation is needed at the level of the Constitution. The protection of the rights and interests of new generations also requires constitutional rules that prevent excessive public indebtedness and ensure a relative balance of the general government. The most important principles of compiling the budget, such as the requirements of transparency, specification and completeness have to be included at the level of the Constitution as well. Moreover, it must be recognised that the budget has to provide resources for the obligations and tasks laid down in the Constitution and the relevant laws.

Accordingly, I called for a separate chapter to be included in the Constitution to address public finances. This requirement is also supported by the interrelations between international and domestic constitutional laws. Nearly all constitutions of the Member States of the European Union contain such chapters along with detailed rules.

As I said at the beginning of my presentation, "Order creates value". I would like to conclude with a similar wise saying: keep order, and order will keep you. I am convinced, and I hope what has been said is a convincing demonstration, that – with the words of *Attila József* – a fair order would help emerge from this crisis and put the Hungarian economy on a sustainable growth path.

Notes

[1] Edited version of the presentation given at the 48th Itinerary Congress of Economists in Szeged on 1 October 2010

[2] Source: CSO

[3] In addition, our audit of the final accounts revealed that this had taken place through the circumvention of law and the exclusion of social partners.

[4] Gyula Pulay: Budgetary risks of the global economic crisis, presentation at the meeting of the Economic and Social Council on 28 January 2009

[5] Source: Statisztikai Tükör, 2010, issue 48; Lakossági lakáshitelezés, 2009. II. félév (Housing loans to households, 2009 H2)

[6] Chapter XI, Title 14, Sub-title 1; the amended appropriation is HUF 205,532 million compared to the actual disbursement of HUF 199,289.3 million.